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No. 311

In the Supreme Court of the United States

OCTOBER TERM, 1929

WALTER A. MAY, HERBERT L. MAY, EDWIN C. MAY, ET AL., EXECUTORS OF THE LAST WILL AND TESTAMENT OF PAULINE MAY, DECEASED, PETITIONERS

v.

D. B. HEINER, COLLECTOR OF INTERNAL REVENUE FOR 23RD DISTRICT OF PENNSYLVANIA

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT

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v

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the District Court (R. 32) is reported in 25 F. (2d) 1004. In a per curiam opinion (R. 41), the Circuit Court of Appeals affirmed the judgment on the opinion of the District Court.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on January 9, 1929. (R. 41–42.) Petition for a rehearing was denied June 24, 1929.

(R. 42.) Petition for writ of certiorari was filed August 8, 1929, and was granted October 21, 1929. (R. 43.) The jurisdiction of this Court rests on Section 240 (*a*) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The question is whether under Section 402 (*c*) of the Revenue Act of 1918 there should be included in the gross estate of a decedent for purposes of estate tax the corpus of a trust created by the decedent in 1917 under which the income was payable to decedent's husband during his lifetime and after his death to the decedent during her lifetime, and after her death the corpus of the trust was to be distributable to remaindermen.

Petitioners have raised the further question whether such a tax may be retroactively imposed, but under respondent's theory no such question arises.

STATUTE INVOLVED

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1097, provides as follows:

> SEC. 402. That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—
>
> * * * * * *
>
> (c) To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has

at any time created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death (whether such transfer or trust is made or created before or after the passage of this Act), except in case of a bona fide sale for a fair consideration in money or money's worth. * * *

STATEMENT

Pauline May died March 25, 1920, in the State of Pennsylvania. (R. 3.) On May 15, 1917, she signed a written statement in which she declared an intention to set up a trust in favor of her husband, herself, and children. (R. 12.) On October 1, 1917, she executed a formal trust agreement, by which a trust estate was established. It was provided that the income from the estate should be paid to her husband, Barney May, during his lifetime, and after his death to the settlor during her lifetime; and after her death the corpus was to be distributed equally among four children. (R. 13–14.) It does not appear in the record whether Pauline May predeceased her husband or not (pp. 2, 4, 7, 14).

The petitioners made a return for the Federal estate tax in which they did not include the value of the securities in the trust estate. (R. 6.) The Commissioner of Internal Revenue added to the gross estate the value of these securities, and by reason thereof assessed and collected the additional tax here in dispute. The tax was paid under protest, and a claim for refund thereafter made was

rejected by the Commissioner. (R. 7–8.) Thereupon this suit was brought. The trial court gave judgment to the respondent on a motion to strike. (R. 31, 38.) The judgment was affirmed by the Circuit Court of Appeals. The petition for certiorari was not opposed.

SUMMARY OF ARGUMENT

The statute reaches all transfers of a testamentary character. It is established that a taxable transfer results from the termination by death of any of the legal incidents of property through which its use or economic enjoyment may be controlled. Where a trust is created under which the settlor reserves the income or use of the property during life and upon his death the corpus is distributed to designated beneficiaries, it has been held in both Federal and State courts that a taxable transfer occurs at the time of the settlor's death. Even though the life interest in the income from a trust is contingent, there is created thereby a legal incident of property which deprives the ultimate beneficiaries of the use or enjoyment of the property until after the death of the person having the right. It is submitted that the termination of such a right results in a shifting of the economic benefits of the property, whether the life interest was actually enjoyed or not.

The record fails to show whether Pauline May had a present right to enjoyment of the income or only a contingent right. Because of the rule that

the taxpayer must show all the facts essential to enable him to recover, and the rule that the Commissioner's assessment is *prima facie* correct, the judgment should be affirmed if sustainable on either theory of the case. The tax was properly reckoned upon the value of the corpus of the trust.

The tax is not imposed upon the incomplete transfer in 1917 which created the trust, but upon the transfer at the maker's death in 1920 of the use and enjoyment which she retained during her life time. Thus the imposition of the tax under the Revenue Act of 1918 involves no question of retroactivity. Moreover, the Act of 1918 as applied to this trust created in 1917 may not be regarded as arbitrarily imposing an unexpected liability since an identical tax was then provided by the Act of 1916.

ARGUMENT

I

CONGRESS HAS POWER, UNDER THE CONSTITUTION, TO IMPOSE, AND BY THE ACT OF 1918 HAS IMPOSED, AN ESTATE TAX MEASURED BY THE VALUE OF PROPERTY IRREVOCABLY TRANSFERRED BY A DECEDENT IN HER LIFETIME, BUT SUBJECT TO A RESERVATION TO THE DECEDENT OF A LIFE ESTATE THEREIN

Section 402 (c) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, includes in the gross estate of every decedent "any interest * * * with respect to which he has at any time created a trust * * * intended to take effect in possession or enjoyment at or after his death." With respect to this statute

it has been said in the case *Y. M. C. A.* v. *Davis*, 264 U. S. 47, 50:

> What was being imposed here was an excise upon the transfer of an estate upon death of the owner.

The opinion of this Court in *Chase National Bank* v. *United States*, 278 U. S. 327, indicates that a taxable transfer results from the termination by death of *any* of the legal incidents of property through which its use or economic enjoyment may be controlled. It was then said (pp. 334–335):

> The precise question presented is whether the termination at death of that power and the consequent passing to the designated beneficiaries of all rights under the policies freed of the possibility of its exercise may be the legitimate subject of a transfer tax, *as is true of the termination by death of any of the other legal incidents of property through which its use or economic enjoyment may be controlled.* (Italics ours.)

In that case the power to change the beneficiary was reserved by the decedent in insurance policies on his life in favor of his wife. It was decided that the power was a limitation of the gift which made it incomplete as to the donor as well as to the donee and that the termination of such power by death brings about "the completion of that shifting of the economic benefits of property which is the real subject of the tax." To the objection that the beneficiaries' interests in the policies were transferred to them from the insurer rather than from the de-

cedent, this Court answered that the word "transfer" in the statute is not to be taken in any restricted sense and that the power to tax the privilege of transfer at death can not be controlled by the mere choice of the formalities which may attend the donor's bestowal of benefits on another at death, but that the termination of the power at death operated as an effective transfer which was subject to tax.

If we disregard, in the trust under consideration, the provision in favor of decedent's husband, Barney May, we have the very common case of an absolute transfer of property containing a reservation to the transferor of the life use thereof. Under this point we shall consider the trust on this basis. Under the next we shall take up the question whether the provision in favor of Barney May changes the character of the transfer so as to affect the application of the taxing statute.

The general characteristics of a testamentary disposition, putting aside matters of form, are that the property go over at the death of the testator, and that during his lifetime he have the possession, enjoyment, or control. It has been frequently held that a trust under which the settlor receives the income of property during life, and upon his death the corpus is distributed to designated beneficiaries, involves a transfer to such beneficiaries intended to take effect in possession or enjoyment at or after the settlor's death, and is subject to an inheritance tax. The fact that the corpus of the

trust estate is irrevocably vested at the time the trust is created is held to be immaterial, as neither possession nor enjoyment within the meaning of the law takes effect until the death of the settlor (*McCaughn* v. *Girard Trust Co.* (C. C. A. 3rd), 11 F. (2d) 520; *Reed* v. *Howbert* (Colo), 8 F. (2d) 641; *Una Libby Kaufman*, 5 B. T. A. 31; *Matter of Green*, 153 N. Y. 223; *Crocker* v. *Shaw*, 174 Mass. 266; *Carter* v. *Bugbee*, 91 N. J. L. 438; *Todd's Estate* (No. 2), 237 Pa. 466.) See also *Tips* v. *Bass* (W. D. Tex.), 21 F. (2d) 460. This principle is recognized generally. (See Gleason & Otis' Inheritance Taxation, 2d ed., p. 125 et seq.)

Carnill v. *McCaughn* (E. D. Pa.), 30 F. (2d) 696, is to the contrary. (*Cf.* also *Frew* v. *Bowers* (C. C. A. 2d), 12 F. (2d) 625; *Boyd* v. *United States* (D. Conn.), 34 F. (2d) 488.) *Carnill* v. *McCaughn* is now pending in the Circuit Court of Appeals for the Third Circuit. In deciding it the District Court held that the decisions of this Court in *Nichols* v. *Coolidge*, 274 U. S. 531; *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339; and *Chase National Bank* v. *United States, supra*, have modified the doctrine relied upon by the Circuit Court of Appeals for the Third Circuit in the instant case and in *McCaughn* v. *Girard Trust Co., supra*. The above-mentioned decisions of this Court were expressly brought to the attention of the court below in the instant case, which affirmed the judgment of the District Court in favor of the Government in a *per curiam* opinion (R. 41), in which it was said that this case is dis-

tinguished from *Nichols* v. *Coolidge, supra,* on the facts. A petition for rehearing was thereafter denied. (R. 42.) We submit that *Reinecke* v. *Northern Trust Co.* and *Chase National Bank* v. *United States, supra,* do not warrant the interpretation given them in *Carnill* v. *McCaughn, supra.* The learned District Judge was evidently of the same opinion that he had expressed earlier in *Girard Trust Co.* v. *McCaughn,* 3 F. (2d) 618, where he held in substance that although the income was reserved by the settlor the interest which the remainderman had was nevertheless vested in possession and enjoyment before the death of the settlor. Upon review that case was reversed. *McCaughn* v. *Girard Trust Co., supra.* This Court in *Chase National Bank* v. *United States, supra,* rejected a similar theory in the following language (p. 334):

> It is true, as emphasized by plaintiffs, that the interest of the beneficiaries in the insurance policies effected by decedent "vested" in them before his death and that the proceeds of the policies came to the beneficiaries not directly from the decedent but from the insurer. But until the moment of death the decedent retained a legal interest in the policies which gave him the power of disposition of them and their proceeds as completely as if he were himself the beneficiary of them.

In *Reinecke* v. *Northern Trust Co., supra,* the two revocable trusts, which were held by this Court to be subject to inclusion in the value of the decedent's gross estate, contained a reservation of

income to the settlor for life, but the effect of such a reservation was not passed upon by this Court or by the Circuit Court of Appeals for the Seventh Circuit. (See 24 F. (2d) 91.) In the five trusts which were there held to be beyond the reach of the statute the settlor had reserved none of the income for himself, and the transfers of the remainder interests at his death did not then pass from his own possession, enjoyment, or control. This Court said (p. 348):

> * * * we think it at least doubtful whether the trusts or interests in a trust intended to be reached by the phrase in section 402 (c) "to take effect in possession or enjoyment at or after his death," include any others than those passing from the possession, enjoyment or control of the donor at his death and so taxable as transfers at death under section 401.

The plain import of this language is that the statute does include all transfers which pass directly from the possession, enjoyment, or control of the decedent.

The right to enjoy the income is what gives property value, and the reservation of that right is equivalent to the continued ownership of the property. With reference to a settlor who conveyed personal property in trust, the income to be paid to him during his life, it was said in *Reed* v. *Howbert*, *supra* (p. 644):

> He continued to enjoy the income as before the transfer. He had a right of action

against the trustee for waste, and could assign or transfer his life interest, in whole or in part, as he might see fit. His income therefrom was not fixed, but still subject to any fluctuations in the dividends or interest earned by the securities the same as before the conveyance.

We think the better view is that the cessation by death of such a present right to receive income constitutes a taxable transfer.

II

THE IMPOSITION OF THE TAX UNDER CONSIDERATION IS NOT AFFECTED BY THE FACT THAT THE PROPERTY TRANSFERRED WAS SUBJECTED BY THE TRANSFEROR TO A FURTHER RESERVATION OF A LIFE ESTATE THEREIN IN FAVOR OF HER HUSBAND

In May, 1917, the decedent declared her intention to establish a trust requiring the trustees "to pay to B. May the net income for life, and after his death to Pauline May for life, if she survive him; and *after the death of both of them* the said property is to be divided equally among her sons and daughter." (R. 12.) (Italics ours.) In the trust agreement executed on October 1, 1917, it was provided that the trustees should pay the net income "to Barney May during his lifetime, and after his decease to Pauline May during her lifetime, and *after her decease* all the property in said trust" was to be distributed among their children. (R. 14.) (Italics ours.)

The language of the trust agreement is perhaps susceptible of the construction that the reservation of income should terminate and the corpus be distributed to the children immediately upon the settlor's death, whether the husband survived her or not. In that case the children would enter into complete possession and enjoyment when the settlor died. If the husband's life interest continued beyond her death, the reservation would continue during his lifetime. But in either case her death would relieve the trust from the burden of her reserved life interest; and in either case the trust was intended to and did as to the children "take effect in possession or enjoyment at or after" her death.

Assuming but not conceding that under the trust agreement the right of the husband to the income would continue after the settlor's death in the event he survived her, we proceed to deal with the suggestion that the interposition of an additional life interest in favor of the husband alters the legal situation.

Petitioners state in their brief that decedent's husband survived her. This does not appear in the record, which consists of an amended statement of claim with exhibits and a motion to strike. (R. 2–31.) It is settled that in an action like this the taxpayer carries the burden of establishing all facts necessary to a recovery. *Botany Mills* v. *United States,* 278 U. S. 282; *United States* v. *Anderson,*

269 U. S. 422; *United States* v. *Mitchell*, 271 U. S. 9; *Reinecke* v. *Spalding*, No. 59, October Term, 1929, decided January 6, 1930. It is also settled that an assessment made by the Commissioner is *prima facie* correct. *United States* v. *Rindskopf*, 105 U. S. 418, 422; *Wickwire* v. *Reinecke*, 275 U. S. 101, 105.

In any event, we contend that the termination by death of a contingent life estate will support the tax, which is one imposed upon "an interest which closed by reason of death." *Y. M. C. A.* v. *Davis*, 264 U. S. 47; *Edwards* v. *Slocum*, 264 U. S. 1. The right of the decedent to receive the income of this trust for life in the event she survives her husband is a right which may postpone the enjoyment by the remaindermen of the economic benefits of the property transferred. The termination of this right by the death of the decedent, freeing the remainder of the possibility of its exercise, is a transfer within the meaning of the statute, properly measured by the value of the property thus relieved of the burden.

The statute imposes a tax on transfers by descent or by will which take effect at the death of the testator and also a tax upon transfers made in contemplation of death, although nothing actually passes at death. It was but logical to tax transfers partaking of the characteristics of both these classes, intended to take effect at or after death of the transferor, though death was not actually im-

pending. (Cf. *Keeney* v. *New York*, 222 U. S. 525, 536.)

The right of the decedent to receive the income in the event that she survived her husband, like the right of the insured in *Chase National Bank* v. *United States, supra,* to change the beneficiary, is a legal incident of property which deprives ultimate beneficiaries of the enjoyment of their estates until after her death.

The failure to exercise the right made no difference in the *Chase National Bank case,* it being there said (p. 338):

> And the non-exercise of the power may be as much a disposition of property testamentary in nature as would be its exercise at death, * * *.

It follows that the termination by death of the mere existence of an outstanding right of enjoyment operates as an effective transfer, and we submit that the death of Pauline May terminated such a right. Had she relinquished even a contingent right to the income before death there would surely have been a shifting of the economic benefits of the property, inuring to those who owned the property subject to that right. The termination of that right at or after death has the same effect.

A situation similar to the instant case existed in *Curley* v. *Tait,* 276 Fed. 840. In that case there were four gifts, some to the Johns Hopkins Hospital, others to the Johns Hopkins University. In each of three agreements of transfer the trans-

feree agreed to pay the net income to Grafflin, the transferor, during his lifetime and after his death to his wife. In the fourth agreement the hospital covenanted to pay the net income to the wife during her life and afterwards to Grafflin if he survived her. Upon Grafflin's death before his wife the Government contended that the value of all these gifts should be included in his estate. The court decided that the hospital was not to enjoy the property comprised in the fourth agreement until after the death of Grafflin but held further that the entire interest was not taxable, reserving the question of whether the Government was entitled to any part of the tax less than the whole. No further report of the case appears, but the language of the court with respect to the postponement of enjoyment by the ultimate beneficiaries is pertinent here. The court said (p. 841):

> To the man in the street, the enjoyment of a share of stock would be found in the right to apply to his own uses the dividends that might be declared upon it, and from this standpoint there is so much force in the government's contention that neither Hospital nor University enjoyed their gifts during Grafflin's lifetime, that without further discussion it may, for the purpose of this case, be assumed to be sound, although it will be unnecessary so to decide.

Hirsh v. *United States* (Ct. Cls.), 35 F. (2d) 982, is distinguishable on the facts. In that case

there was an outright transfer of securities to the decedent's children, who agreed to pay a life annuity in a specified sum to his wife and to the decedent for his life in case he survived her. It was held that no trust was created by the agreements; that the securities were not charged with the annuity; that the transferees entered into the possession and enjoyment of the securities; that no restriction was placed upon their sale or disposal; that each child was personally obligated to pay a specific annuity, regardless of whether any return was received on the securities; and that each was financially able to pay the annuity. The case turned on the construction of the agreements and involved no departure in principle from the instant case.

The fact that the intervening life estate might extend beyond the date of the settlor's death does not alter the situation. Since the enjoyment of the economic benefits from the property did not take effect in the remaindermen prior to the settlor's death, it does not matter that it was or might have been postponed to a time subsequent to her death. The language of the statute includes just such a situation. The grant of the life estate to the husband did not depend upon the continuance or the cessation of the life of the settlor and did not constitute a taxable transfer. So far as the effect of the transfer to the remaindermen is concerned, it is immaterial whether the settlor retained the income to herself or directed its payment to some

third person, for the tax is imposed on the interest that ceased upon her death.

We submit that upon the death of Mrs. May there occurred a taxable transfer within the meaning of the statute as interpreted by this Court in the cases heretofore discussed. This transfer comprised the right to receive the income which is "that which gives value to property." *Pollock* v. *Farmers' Loan & Trust Co.*, 158 U. S. 601, 628. Accordingly, the tax was properly reckoned upon the value of the corpus of the trust relieved of the burden of the settlor's life estate, just as the tax in *Reinecke* v. *Northern Trust Co., supra*, was held to be rightly imposed on the transfers of the corpus of the two trusts.

III

THE TAXABLE TRANSFER WAS COMPLETED UPON THE SETTLOR'S DEATH IN 1920 AND THE IMPOSITION OF THE TAX BY THE REVENUE ACT OF 1918 INVOLVES NO QUESTION OF RETROACTIVITY

The trust here involved was established October 1, 1917, subsequent to the passage of the Revenue Act of 1916 and prior to the enactment of the Revenue Act of 1918. The settlor died on March 25, 1920, which was within the taxing period covered by the Revenue Act of 1918, under which the tax in dispute was assessed and collected. The Revenue Act of 1916 imposed a similar tax and accordingly it can not be said in this case that the settlor established the trust with no knowledge of the tax.

Thus the Revenue Act of 1918 did not impose "an unexpected liability that if known might have induced those concerned to avoid it and to use their money in other ways." *Llewellyn* v. *Frick,* 268 U. S. 238, 252. We therefore submit that in imposing a death duty upon a transaction which was in its nature testamentary and in which the settlor retained an interest up to the time of her death there is nothing arbitrary, capricious, or burdensome.

We have heretofore contended that the settlor had reserved an interest in the trust property which deprived the ultimate beneficiaries of the enjoyment of their estates until after her death, and that this Court has already held that the termination of such an interest by death brings about "the completion of that shifting of the economic benefits of property which is the real subject of the tax." *Chase National Bank* v. *United States, supra* (p. 338).

In this case the transfer of 1917 was not completed until the transfer of the decedent's interest in the trust, which occurred at her death in 1920. The interest which was transferred upon the death of Pauline May passed directly from her possession, enjoyment, or control and hence it was properly included in the gross estate. Since the taxable transfer was completed March 25, 1920, subsequent to the effective date of the taxing statute, there can be no question of retroactivity.

It can make no difference that the trust agreement was made prior to the time of the enactment of the taxing statute, because the tax has not been imposed upon that incomplete transfer. The tax is an excise on the exercise of the privilege of transferring the property of a decedent at death. *Chase National Bank* v. *United States, supra.* It is the exercise of the privilege *during the taxing period* which is the subject upon which the statute places the excise duty. Cf. *Billings* v. *United States,* 232 U. S. 261, 280. The statute involved in that case was passed near the close of the taxing period, which was the only occasion for the discussion of retroactivity. As in that case, the tax here is valid because there was an exercise of the privilege within the taxing period.

This case is not like *Nichols* v. *Coolidge,* 274 U. S. 531, where Section 402 of the Revenue Act of 1918 was held to be invalid in so far as it required that there should be included in the gross estate the value of property transferred by a decedent prior to its passage. In that case the settlors during their lifetime assigned to the beneficiaries their entire interests in the property, especially any right to the income therefrom. No interest whatever was retained by the settlors, so that nothing passed at death, and the only possible occasion for the tax was the transfer to the trustees many years prior to the statute. The decision turned on the point that (p. 540) "the conveyance by Mrs. Coolidge to

trustees was in no proper sense testamentary, and it bears no substantial relationship to the transfer by death." In this case the completion of the transfer at death gave it the testamentary character which was lacking in the *Coolidge case*.

The occasion for the tax here was the exercise during the taxing period of the privilege of transfer at or after death. Death and the resulting transfer occurred within the taxing period, and the establishment of the testamentary character of the transfer within the taxing period disposes of any question of the validity of the tax.

CONCLUSION

In view of the foregoing, it is submitted that the judgment of the court below should be affirmed.

Respectfully submitted,

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